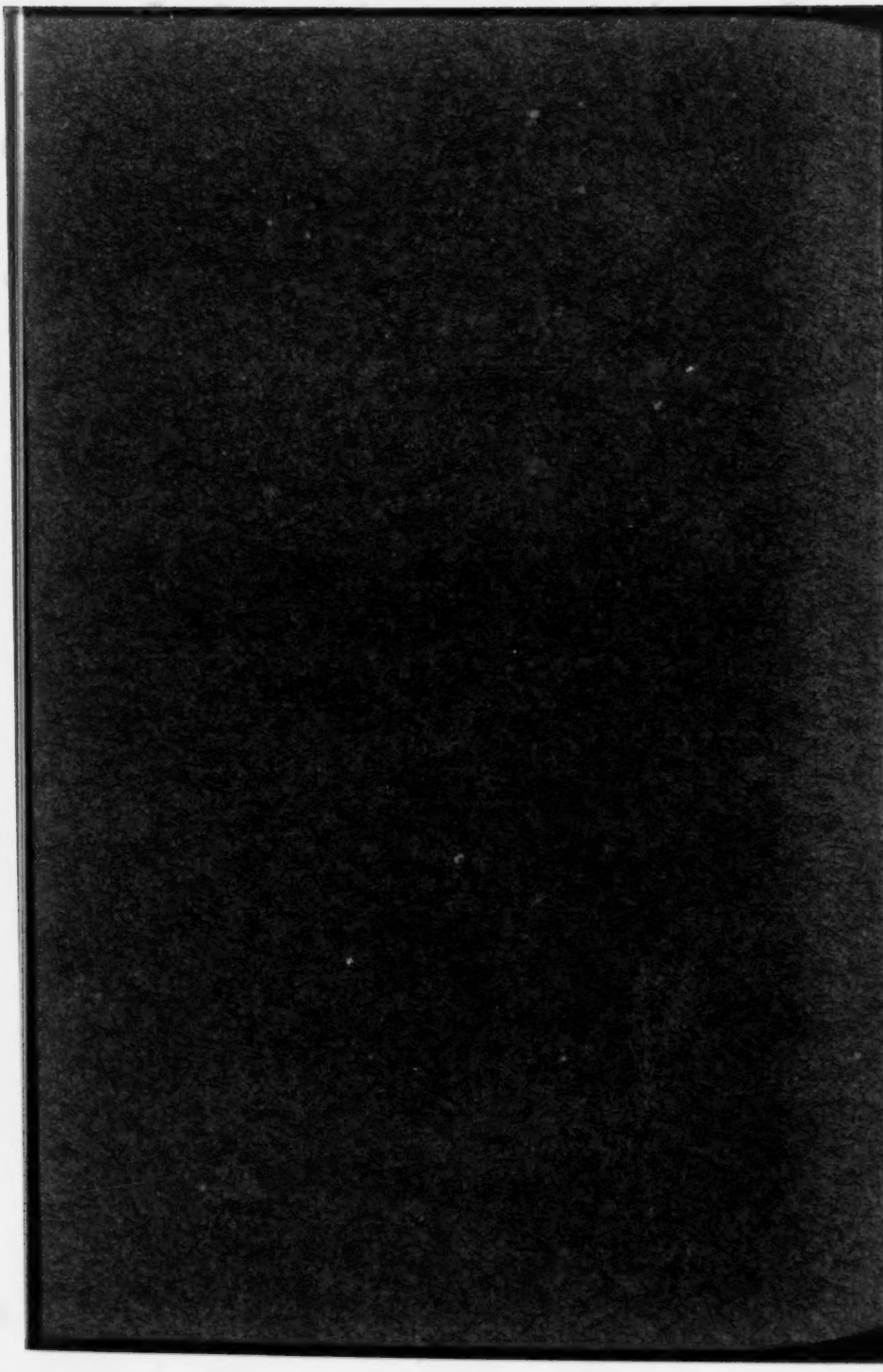

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and regulations involved	2
Statement	4
Argument	7
Conclusion	11

CITATIONS

Cases:	
Carol v. *Commissioner*, 30 B. T. A. 443	10
Chisolm v. *United States*, 19 F. Supp. 274	9
Commissioner v. *Gutman*, 143 F. 2d 201	10
Helvering v. *Falk*, 291 U. S. 183	10
Magruder v. *Washington, B. & A. Realty Corp.*, 316 U. S. 69	8
Newbury v. *Commissioner*, 26 B. T. A. 101	9
Taft v. *Commissioner*, 304 U. S. 351	8
Tait v. *Western Md. Ry. Co.*, 289 U. S. 620	9
United Shoe Mach. Co. v. *United States*, 258 U. S. 451	9
United States v. *Dakota-Montana Oil Co.*, 288 U. S. 459	8
Statutes:	
Internal Revenue Code:	
Sec. 23 (26 U. S. C. 1940 ed., Sec. 23)	7
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 23	7
Revenue Act of 1932, c. 209, 47 Stat. 169:	
Sec. 23	7
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 23	7
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 23	27
Revenue Act of 1938, c. 289, 52 Stat. 447:	
Sec. 23	7
Revenue Act of 1942, c. 619, 56 Stat. 789:	
Sec. 121 (26 U. S. C. (Supp. III, 23)	27
Miscellaneous:	
H. Rep. No. 1882, 70th Cong., 1st Sess., pp. 11–12 (1939–1 Cum. Bull. (Part 2) 444, 445)	7
S. Rep. No. 960, 70th Cong., 1st Sess., p. 20 (1939–1 Cum. Bull. (Part 2) 409, 423)	7

Miscellaneous—Continued. Page

Treasury Regulations 74, Art. 201 8
Treasury Regulations 77, Art. 201 8
Treasury Regulations 86, Art. 23 (1)–1 8
Treasury Regulations 94, Art. 23 (1)–1 ..... 3, 8
Treasury Regulations 101, Art. 23 (1)–1 8
Treasury Regulations 103, Sec. 19.23 (1)–1 8
Treasury Regulations 111, Sec. 29.23 (1)–1 8

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 418

FRANCICE NETCHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 35–42) is unreported.[1] The opinion of the Circuit Court of Appeals (R. 57–64) is reported in 143 F. 2d 484.

[1] In the Tax Court, this case was consolidated (R. 2, 35) with *Ethel Netcher Chagnon* v. *Commissioner* (T. C. No. 107723); *Mollie Netcher* v. *Commissioner* (T. C. No. 107724); *Townsend Netcher* v. *Commissioner* (T. C. No. 107725); and *Irving Netcher* v. *Commissioner* (T. C. No. 107726). Appeals to the Circuit Court of Appeals for the Seventh Circuit have been taken in all of these cases except *Ethel Netcher Chagnon* v. *Commissioner;* but, by order of that court, filed June 23, 1943 (R. 47–48), only the record in the present case was printed; further proceedings in the other cases are to await the final outcome of the instant litigation.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 8, 1944 (R. 65). The petition for a writ of certiorari was filed September 1, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the income beneficiaries of a certain trust are entitled under Section 23 (l) of the Revenue Act of 1936 to an allowance for depreciation on trust assets not absorbed by the trust income, where the trust instrument, as construed by the Tax Court and the court below, required that the trustee, in determining the distributable income, should withhold an amount sufficient to offset depreciation.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be com-

puted as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (l)–1. *Depreciation.*— * * * In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust com-

puted without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

STATEMENT

The Tax Court found the following facts (R. 35–38):

The taxpayers, Ethel Netcher Chagnon,[2] Townsend Netcher and Irving Netcher, are children of Charles Netcher, who died on June 19, 1904, a resident of Cook County, Illinois. The taxpayers, Francice Netcher and Mollie Netcher, are children of Charles Netcher, Jr., who died on November 4, 1931, and who was also a child of the above-mentioned Charles Netcher. (R. 35.)

By the will of Charles Netcher, the bulk of his entire estate was left in trust to his widow, Mollie Netcher, now Mrs. Mollie Netcher Newbury. One-third of the net income from the trust estate was to be paid to her for life, with the power by her will or deed to dispose of the right to such

[2] As indicated in the previous note, no appeal has been taken in the case of Ethel Netcher Chagnon.

income from the date of her death to the termination of the trust. The income from the remaining two-thirds of the estate was to be divided by the widow, as trustee, into four equal portions, each of such portions to be thereafter held in trust by the trustee as a separate trust fund for each of the testator's children. (R. 36.)

The will further provided that until each of such children attained the age of 25 years, the trustee should use and expend so much of each separate trust fund held for each child as in her opinion was necessary for the education and support of such child. On attaining his twenty-fifth year, each child was to become entitled to receive the entire income from the separate trust and also to become entitled thereafter to one-fourth of the net income of the above-mentioned two-thirds of the principal trust estate. The trust was not to terminate until the death of the last survivor of the decedent's widow and his four children.[3] In case of the death of one of the decedent's children leaving issue, the latter were to take the interest of the parent subject to an annuity payable to the widow of the deceased child. (R. 36.)

One of the assets included in the trust *res* was certain real property in Chicago, Illinois. Following the testator's death, the widow, acting as

[3] This finding seems incorrect, since the will expressly provides (R. 20) for termination when all the children have died and the youngest living grandchild has reached the age of 21.

trustee under the will, borrowed the necessary funds and erected on this property a seventeen-story fireproof store and office building at a cost of $5,714,759.52, which was thereupon leased to the Boston Store. (R. 36.)

For the calendar year 1937, the sum of the charges for ground rent, interest on mortgage, taxes, and depreciation on the building exceeded the rents by the sum of $102,843.50. This deficit was treated as part of the expenses of the so-called principal trust. The charge for depreciation was an allowance for the loss sustained through exhaustion, wear, and tear of the building and in computing the distributed income of the trust the trustee has continuously deducted from the gross income of the principal trust estate an allowance for depreciation of this asset and has set up a reserve to cover the loss so sustained. The balance in the reserve account on December 31, 1936, was $1,969,676.66, and on December 31, 1937, was $2,112,545.64. (R. 36–37.)

For the year 1937, depreciation sustained on all the properties of the trust estate amounted to $142,868.98, and after the deduction of this amount the principal trust sustained a net loss of $133,993.24 (R. 37).

The Commissioner determined that the depreciation sustained on properties of the principal trust estate in the tax year was deductible only by the trustee in computing net income of the estate, and that any depreciation not thus set off

and consequently reported in the net loss of the estate was not subject to deduction by the individual beneficiaries from income received by them from other sources (R. 13, 38). The Tax Court reversed the Commissioner (R. 39), but the court below set aside the decision of the Tax Court and upheld the Commissioner (R. 64).

ARGUMENT

Section 23 (l) of the Revenue Act of 1936, *supra*,[4] provides that in the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. This provision came into the law in Section 23 (k) of the Revenue Act of 1928, and it has been continued in subsequent acts. Section 23 (k), 1932 Act; Section 23 (1), 1934, 1936, and 1938 Acts and the Internal Revenue Code. The committee reports relating to the 1928 Act (S. Rep. No. 960, 70th Cong., 1st Sess., p. 20 (1939–1 Cum. Bull. (Part 2) 409, 423); H. Rep. No. 1882, 70th Cong., 1st Sess., pp. 11–12 (1939–1 Cum. Bull. (Part 2) 444, 445), contain the following example:

[4] The law was amended in certain respects by Section 121 (c) of the Revenue Act of 1942, but these amendments, although retroactive, are not relevant to the present controversy.

> if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

This example was incorporated in the regulations, and it has remained unaltered therein for many years. Article 201, Treasury Regulations 74 and 77; Article 23 (l)–1, Treasury Regulations 86, 94 and 101; Section 19.23 (l)–1, Treasury Regulations 103; Section 29.23 (l)–1, Treasury Regulations 111. It is entitled, therefore, to substantial weight in construing the statute. *Taft* v. *Commissioner,* 304 U. S. 351; *United States* v. *Dakota-Montana Oil Co.,* 288 U. S. 459; *Magruder* v. *Washington, B. & A. Realty Corp.,* 316 U. S. 69.

The court below properly relied upon the example (R. 63) in holding that the deduction is allowable in full to the trustee and not to the beneficiaries. The will, although containing no specific provision as to depreciation, provides that the real estate should be held together for the benefit of the entire estate and the benefici-

aries thereunder. The beneficiaries for many years took the view that their distributive shares should be reduced by depreciation, and in an earlier case relating to their income taxes for the years 1923 to 1925 (*Newbury* v. *Commissioner,* 26 B. T. A. 101), the Board of Tax Appeals so held, and the Commissioner acquiesced (XI–2 Cum. Bull. 7 (1932)). Indeed, such decision might well be considered determinative of the present controversy under the doctrine of *res judicata* (*Tait* v. *Western Md. Ry. Co.,* 289 U. S. 620; *United Shoe Mach. Co.* v. *United States,* 258 U. S. 451, 459) because the question of construction there decided is also determinative of the issue here presented, even though the tax years and statutory provisions are different.

Under these circumstances there is little merit in the taxpayer's contention that the deduction should be split between the trustee and beneficiaries so as to give to the beneficiaries the right to deduct from their income derived from other sources such part of the depreciation as is not needed by the trustee as an offset to trust income. The cases relied upon in the petition are distinguishable on their facts, and there is no conflict. In *Chisolm* v. *United States,* 19 F. Supp. 274 (C. Cls.), the beneficiary was held entitled to the entire deduction. There, however, the trust instrument as construed by the court provided for distribution of the trust income to the beneficiaries

without a deduction for depreciation. Here the trust instrument provides in effect that the trustee in determining distributable income should withhold an amount sufficient to offset depreciation. In *Commissioner* v. *Gutman,* 143 F. 2d 201 (C. C. A. 2d), the court held that the income in question could never become part of the corpus, or be allocable to anyone other than the beneficiary; the beneficiary was held to be entitled, therefore, to the depreciation deduction. In *Carol* v. *Commissioner,* 30 B. T. A. 443 (Acq., XIII–2 Cum. Bull. 4 (1934)), the beneficiary was entitled to the entire income without deduction for depreciation, and hence was entitled to take deduction of the depreciation in the trust property, regardless of the fact that in the particular tax year there was no income therefrom. *Helvering* v. *Falk,* 291 U. S. 183, held only that the beneficiaries receiving royalties from mineral property could deduct under earlier statutes an allowance for depletion representing the return of capital assets.

It is submitted, therefore, that the court below correctly applied the law to the facts here presented, and there is no occasion for further review by this Court. The basic inquiry in this case—whether, under the trust instrument, the trustee had a right and a duty to retain enough from trust income to offset depreciation—turns on the particular facts presented, and is not of general importance. No conflict of decisions is shown.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH,
L. W. POST,
Special Assistants to the Attorney General.

SEPTEMBER 1944.

U. S. GOVERNMENT PRINTING OFFICE: 1944